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SENSITIVE
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SUBJECT: KAZAKHSTAN - CASPIAN OIL PRODUCTION, PLANS, AND PROSPECTS

¶1. (SBU) Summary. Oil production at Tengiz has expanded to 540,000 barrels per day (bpd) and the Kashagan consortium is expected to produce at least 150,000 bpd by 2013 and up to 1.5 million bpd by ¶2020. Tengizchevroil (TCO) could easily increase oil production to 600,000 bpd but is constrained by a lack of rail car and pipeline capacity. TCO also faces ongoing issues with workforce development, sulfur storage, and facility security. End summary.

PRODUCTION AT KAZAKHSTAN'S SUPER-GIANT FIELDS
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¶2. (SBU) Charge and Energy Officer toured Tengiz with TCO Deputy Manager for Government and Public Affairs Linsi Crain on September ¶19. Total recoverable oil at the Tengiz and Korolev fields through April 2033 is estimated at 750 million to 1.1 billion metric tons (approximately 6 to 9 billion barrels). Current production capacity is 70,000 metric tons (or 540,000 barrels) of oil per day and 22 million cubic meters (or 765 million standard cubic feet) of gas per day. Crain confided that TCO could easily increase production to 600,000 bpd but is constrained by a lack of rail car and pipeline capacity. The day of our arrival, TCO was expected to start operation of a new sour gas injection and second generation plant, but they postponed the start of operations until the day after our visit, ostensibly for our own safety, given the large gas flares that initial operations would produce. When asked how important TCO was to Chevron, Crain, a Chevron employee seconded to TCO, said they like to joke that "TCO feeds us Monday through Thursday, Gorgon (Australia's large natural gas field) on Friday, and the other guys take care of us on the weekend."

¶3. (SBU) Meanwhile, production at Kashagan, Kazakhstan's other super-giant Caspian shore oil field, is expected to start in 2013. Negotiations are ongoing to turn a January memorandum of understanding (MOU) on restructuring Kashagan into a more formal agreement, with the latest deadline set for October 25. The Government of Kazakhstan and the Kashagan consortium -- Agip KCO -- have reportedly come to agreement on the details of a new operating structure, but not on the terms and timing of production. According to Agip KCO Public Relations Manager Richard Fritz, if the deal holds up, ENI would continue to run the Experimental Program, including onshore, offshore, and drilling operations, and would produce up to 450,000 bpd by the end of that phase of the project. Under Phase 2, ENI would manage onshore operations, while Shell and ExxonMobil would lead offshore production, with ExxonMobil having particular responsibility for developing the Kalamkas field. A new joint operating company, led initially by Total, would be created with overall management responsibility for the consortium. KazMunaiGaz and Shell would also form a new company to manage overall production operations.

¶4. (SBU) Agreement on production volumes and schedules, however, has not been reached. Agip KCO's Fritz told us on September 20 that -- despite press reports -- the Agip KCO consortium is committed to producing just 150,000 bpd by the end of the experimental phase in

2013, not 450,000 bpd, as Minister of Energy Mynbayev was quoted as saying after his visit to Kashagan on September 19. Fritz confided to us that Agip KCO could, if necessary, produce 170,000 bpd right now, using existing appraisal wells. The Kashagan contract includes rights to offshore oil-rich reservoirs at Kalamkas, Kairan, Aktote, and Kashagan SW. In total, Kashagan has up to 38 billion barrels of oil in place, of which 13 billion are potentially recoverable with the use of gas re-injection. By 2020, peak production is expected to be 1.5 million bpd. (Note: In a private dinner with Charge and Energyoff on September 20, Steve Rose, General Manager for ExxonMobil Kazakhstan, told us that he is not fully convinced that Kashagan will live up to the hype. ExxonMobil will drill an appraisal well at Kalamkas in 2009 "to see what we've got." End note).

LIMITED RAIL AND PIPELINE CAPACITY CONSTRAIN TENGIZ PRODUCTION
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¶5. (SBU) TCO currently owns or leases more than 22,000 railroad cars to transport crude, liquid petroleum gas, and sulfur, making it one of the largest rail car operators in the world. According to TCO's Crain, with 4,000 more rail cars, TCO could increase production to 600,000 bpd. Unfortunately, she said, there is a shortage of rail transportation capacity in Kazakhstan and -- in addition to oil and gas -- rail cars are in high demand for the transportation of wheat and cement. Agip KCO's Fritz and Kairat Urazbaev, First Deputy General Director of the Atyrau oil refinery, both confirmed the lack of sufficient rail cars for oil and gas transportation. Agip KCO intends to transport approximately 300,000 bpd of the initial 450,000 bpd production from Kashagan via rail.

¶6. (SBU) In addition, failure to reach agreement on the expansion of

the Caspian Pipeline Consortium (CPC) pipeline has become a serious constraint to increased production for TCO. TCO currently ships 80% of its oil via CPC and noted that it is already near full capacity. Once Kashagan starts production, demand for pipeline capacity will be even greater. Agip KCO's Fritz told us that they have an agreement with CPC to use the pipeline to transport up to 66,000 bpd of oil from Kashagan. Rail and pipeline constraints have encouraged TCO to focus on other means of transport, including tankers. By mid-October, TCO is expected to ship 20,000 bpd by tanker across the Caspian to Baku, where Tengiz oil will flow into the Baku-Tbilisi-Ceyhan (BTC) pipeline for the first time.

QUALITY OF LIFE AND WORKFORCE DEVELOPMENT

¶7. (SBU) Crain described TCO as a $20 billion operation and explained that the consortium has already invested $7 billion in drilling, injection, transportation, and processing facilities at Tengiz. The company recently completed construction of new housing for its 3,000 employees on site. Each of the six new housing units contains a fitness center, swimming pool, and community center. Kazakhstani citizens hold 83% of TCO positions and represent 77% of TCO's managerial workforce. For example, Kazakhstanis hold the company's top positions in the legal, human resources, and public relations departments. Crain said that TCO has made a concerted effort to develop local engineering expertise, particularly among female employees, but has had difficulty. For example, Kazakhstani law prohibits pregnant women from working with or near heavy machinery, which means in practice that as soon as a female engineer discloses her pregnancy (or is found to be pregnant in a routine medical checkup), she must be reassigned to another part of the company. Agip KCO's Fritz also told us that they have had difficulty developing a skilled local workforce, particularly welders and pipe fitters. During the past three years, Agip KCO has trained more than 700 workers for these positions at its Atyrau Training Center, but once the workers find employment, turnover is extremely high. "They don't want to work these long hours or under these difficult conditions," according to Fritz.

¶8. (SBU) TCO has a modern medical center on site, with several doctors on staff. Crain told us that local residents in and around Tengiz come to TCO when they have a medical emergency and women have

been known to come to TCO to have their babies delivered. The dining hall at TCO serves 3,000 people and offers Indian, Asian, and Tex-Mex cuisine. The company prides itself on its safety record There have been no TCO "days away from work" (DAFW) cases since April 2007, which totaled to more than 12 million cumulative man hours without a DAFW injury through July 2008. To promote traffic safety, TCO plans to bring U.S. traffic safety engineers to Atyrau and Almaty in October to conduct training seminars and evaluate local traffic conditions. Crain welcomed the participation of Embassy staff in those activities.

SULFUR STORAGE AND DISPOSAL STILL AN ISSUE

¶9. (SBU) TCO continues to grapple with legal, financial, and public relations issues stemming from the enormous production of sulfur associated with Tengiz oil production. Sagyn Lukpanov, director of the social entrepreneurial corporation Caspiy, reminded us on September 18 that there are 9 million tons of sulfur stored above ground at Tengiz. He acknowledged that for the past year, TCO has been able to sell more sulfur than it produces, particularly to China for agricultural purposes, but claims that the company has not sufficiently addressed the long-term storage and health issues of its sulfur production. (Note: TCO denies that there is any environmental or health impact whatsoever from its on-site above-ground sulfur storage. End Note.) Caspiy, which was created with financial and material support from the local government and remains 49% government-owned, established a working group with TCO, Agip KCO, the Ministry of Energy and Mineral Resources, and the Ministry of the Environment to draft a national strategy for sulfur storage, transportation, and sales. According to Lukpanov, TCO agreed in a meeting this summer with Minister of Energy Mynbayev to eliminate all of the sulfur stored above-ground by 2013. Deputy Akim Nurman Nurbekov told us on September 18 that TCO had agreed to remove all sulfur by 2012. TCO's Crain insisted, however, that TCO had made no firm commitments and that there was no agreement in writing to remove all Tengiz sulfur by a certain date. She said that Chevron's senior leadership is working directly with Deputy Prime Minister Shukayev to resolve this issue. Crain reminded us that TCO paid a fine of $370 million to the oblast government for alleged violations of environmental regulations associated with its sulfur production and storage, but maintained that the central authorities have quietly agreed that TCO may deduct this amount from future royalty payments to Kazakhstan. When asked whether Kashagan will

produce the same levels of sulfur as TCO, Agip KCO's Fritz said, "No, because we will re-inject 80% of the sulfur gas back into the well from a very early stage. In case we do have to store sulfur above ground, we will construct a temporary storage facility where the sulfur blocks will be fully sealed and will have no contact with the air."

SECURITY ISSUES AT TCO

¶10. (SBU) Security at TCO is tight, although there are areas of vulnerability. The company strictly enforces a 100% id check policy on site, even for VIP visitors touring the facility in a TCO vehicle together with senior management. Nevertheless, TCO reports minor problems such as the theft of scrap metals and other materials. A public highway runs directly parallel to TCO's main production facility and private vehicles can approach up to 200 meters of the facility without encountering a roadblock. Steve Witham, TCO's Security Manager, told us that they successfully relocated two local villages before the facility was built and noted that the highway is infrequently traveled. Nevertheless, he acknowledged that the highway posed a security risk and Crain deliberately avoided taking our party down that road for traffic safety reasons. Witham said that cooperation with the local Kazakhstani law enforcement and security forces was generally good, although he characterized them as "inefficient" and "opportunistic."

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